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## **OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT**

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**Date Issued:** March 18, 2010

**IBA Report Number:** 10-26

**City Council Meeting Date:** March 23, 2010

**Item Number:** 331

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# **Review of FY 2010 Mid-Year Budget Monitoring Report and Impact on the FY 2011 General Fund Budget**

## **OVERVIEW**

The Chief Financial Officer issued the Fiscal Year 2010 Mid-Year Budget Monitoring Report on February 24, 2010, which describes the current status of revenues and expenditures, and their year-end projections, based on actual (unaudited) data from July 2009 through December 2009. The report notes that the budget amendments approved by the Council in December 2009, which were necessary to ensure a balanced General Fund budget by year-end and for next fiscal year, have been taken into consideration.

Financial Management staff presented the Mid-Year Budget Monitoring Report to the Budget and Finance Committee meeting of March 3, 2010. At the meeting, our office made verbal remarks regarding the potential impact to the Fiscal Year 2011 General Fund Budget due to reduced revenue estimates for Fiscal Year 2010 as described in the Mid-Year Report.

The Budget and Finance Committee requested that the Mid-Year Budget Monitoring Report be forwarded to the City Council, and also requested that the IBA prepare a report on the projected deficit for Fiscal Year 2011. In addition, a report on vacant positions by department was requested, with an indication of which positions are revenue generating.

## FISCAL/POLICY DISCUSSION

Current projections as reported in the Mid-Year Budget Monitoring Report reflect a net budgetary shortfall of \$11.2 million, however, no budget adjustments are recommended at this time. It is anticipated that mitigation efforts to reduce projected expenditures to eliminate the shortfall will be successful. Continual monitoring of revenues and expenditures will be ongoing, and budgetary adjustments may be required as part of the Year-End Report, expected in mid-May.

The following chart summarizes the FY 2010 Adopted Budget, First Quarter Projection, Revised Budget, and the Mid-Year Projection. Based on the Mid-Year Projection, General Fund revenues are now projected to be \$77 million less than the Adopted Budget, which is a 6.8 percent decrease. General Fund expenditures are projected to exceed revenues, and are estimated to be \$34.3 million less (or 3.0 percent lower) than the Adopted Budget.

General Fund Status Fiscal Year 2010				
	<b>FY 2010 Adopted Budget</b>	<b>FY 2010 Year- End Projection (First Quarter)</b>	<b>FY 2010 Revised Budget (after adjustments)</b>	<b>FY 2010 Year- End Projection (Mid-Year)</b>
Revenues	\$1,129,706,375	\$1,079,342,739	\$1,111,994,517	\$1,052,689,633
Expenditures	\$1,129,706,375	\$1,118,348,876	\$1,111,994,517	\$1,095,441,019
Net Balance	--	(\$39,004,137)	--	(\$42,751,386)
Release PY Funds		\$31,524,767		\$31,524,767
Est. Shortfall		(\$7,479,370)		(\$11,226,619)

The FY 2010 Revised Budget reflects budget reductions and other actions enacted to date to address revenue shortfalls due to the economic decline, including a net reduction of \$22.8 million to the General Fund Budget approved in December 2009. Other Council-approved budget amendments include a \$5 million increase related to a slurry seal contract extension administered by the General Services Department funded primarily with Proposition 42 funds, increasing both General Fund budgeted revenues and expenditures. The net result of these budget amendments is a budget reduction of approximately \$17.8 million.

The Mid-Year Projection reflects further shortfalls in revenues of \$59.3 million, and additional expenditure savings of \$16.5 million, compared to the Revised Budget. After considering the release of prior year budget authorizations of \$31.5 million, the Mid-Year Projection reflects an estimated net shortfall of \$11.2 million at year-end. This shortfall has increased by \$3.7 million (from \$7.5 million) since the First Quarter Report. This estimated shortfall assumes the 7 percent reserve goal target for the General Fund will be achieved for FY 2010.

## General Fund Revenue

The Mid-Year Report reflects revisions to the projections for the major General Fund revenue sources, for a total reduction of \$36.5 million from the Revised Budget. Estimates for departmental revenues comprise the remaining \$22.8 million of the revenue shortfall, for a total General Fund revenue reduction of \$59.3 million.

In general, the IBA has determined that the Mid-Year revenue projections are in line with economic forecasts and current receipt trends, with gradual improvements in performance for some revenues expected over the next two quarters of the fiscal year. Economists are predicting a recovery from the recession in 2010, though it will be a slow, tentative one.

As noted in our previous reports, current year revenue performance will have a negative impact on the previous deficit projection for FY 2011. Keeping all Five-Year Outlook growth assumptions constant and using the Mid-Year revenue projections as a base would equate to an additional revenue shortfall of approximately \$30 million in FY 2011. The chart below details the potential impact of the current year-end projections using Five-Year Outlook assumptions. The Five-Year Outlook forecast of \$1.06 billion would decline by \$30 million to \$1.03 billion.

**General Fund Revenue (in millions)**

<b>GF Revenue (in millions)</b>	<b>FY 2009 Actuals<sup>1</sup></b>	<b>FY 2010 Outlook Projection</b>	<b>FY 2011 Five-Year Forecast</b>	<b>FY 2010 Mid-Year Projection</b>	<b>Potential FY 2011 Impact</b>
Property Tax <sup>2</sup>	\$ 398.7	\$ 391.6	\$ 391.6	\$ 390.6	\$ 390.6
<b>Growth</b>		<b>-1.8%</b>	<b>0.0%</b>	<b>-2.0%</b>	<b>0.0%</b>
Sales Tax	\$ 206.1	\$ 185.4	\$ 176.3	\$ 185.0	\$ 175.9
<b>Growth</b>		<b>-10.0%</b>	<b>-4.9%</b>	<b>-10.2%</b>	<b>-4.9%</b>
TOT	\$ 74.2	\$ 71.2	\$ 71.9	\$ 66.1	\$ 66.8
<b>Growth</b>		<b>-4.0%</b>	<b>1.0%</b>	<b>-10.9%</b>	<b>1.0%</b>
Franchise Fees	\$ 65.1	\$ 73.7	\$ 75.0	\$ 70.0	\$ 71.3
<b>Growth</b>		<b>13.2%</b>	<b>1.8%</b>	<b>7.5%</b>	<b>1.8%</b>
Other Revenue	\$ 379.2	\$ 386.1	\$ 346.8	\$ 363.6	\$ 326.5
<b>Growth</b>		<b>1.8%</b>	<b>-10.2%</b>	<b>-4.1%</b>	<b>-10.2%</b>
<b>Total GF<sup>3</sup></b>	<b>\$ 1,123.3</b>	<b>\$ 1,108.0</b>	<b>\$ 1,061.6</b>	<b>\$ 1,075.3</b>	<b>\$ 1,031.1</b>

1. Unaudited actual.

2. Mid-Year projection denoted for property tax includes the \$22.6 million that will be redirected to a special reserve fund in FY 2010.

3. Total General Fund for FY 2010 includes the \$22.6 million that will be redirected to special reserve fund in FY 2010.

The Financial Management Department is currently reviewing the FY 2011 revenue growth assumptions from the Five-Year Outlook. Beyond the major revenue projections, departmental revenues that represent 38.4 percent of the FY 2010 decline from budget are

being examined to determine their impact, given that a number of these declines were not taken into account in the Outlook projections. The Mayor's April 15<sup>th</sup> FY 2011 Proposed Budget will reflect their revised assumptions based on current economic data and revenue performance since the release of the Outlook in October of 2009.

### **General Fund Expenditures**

The Mid-Year Report describes that General Fund savings of \$16.5 million is caused primarily by savings in the expenditure category of Salaries and Wages, totaling \$12.4 million. Savings in this area help to offset the reductions in major revenue sources and overspending in other expenditure categories. Significant issues in various expenditure areas are described below, with some impacting FY 2010, while others will impact only FY 2011.

### **Salaries and Wages**

In past reports, our office has raised concerns regarding the identification of the full salary and fringe benefit savings in the Police Department, beyond the vacancy factor. The salary and fringe savings of \$21.3 million identified in the Mid-Year Report is consistent with our projections for the Police Department. At the Budget and Finance Committee meeting, Police Department staff indicated that their staffing and hiring assumptions have changed since the First Quarter Report, resulting in additional projected savings coinciding with previous IBA estimates.

### **Retirement ARC**

On January 15, 2010, Mayor Jerry Sanders issued a memorandum to the City Council describing the release of the SDCERS actuarial valuation for the City's retirement system, as of June 30, 2009. The outcome of this report results in the final determination of the City's Annual Required Contribution (ARC) for Fiscal Year 2011. Unfortunately, the final ARC payment is higher than previously projected. As stated in the memo, the General Fund portion of the increased ARC payment is \$15.3 million for FY 2011, increasing the budget deficit.

### **Information Technology**

The budget reductions approved in December 2009, totaling \$179 million, included an estimated reduction of \$3 million in the category of Information Technology for the General Fund for FY 2011. These savings are expected to be generated as a result of a competitive selection process begun last fall, for various services currently provided by San Diego Data Processing Corporation (SDDPC). In addition, approved changes to the Microsoft Enterprise License agreement will save nearly \$500,000 over the next three years, and will assist in meeting the savings target.

At the Rules Committee meeting of March 10, 2010, the Information Technology Department presented a report regarding the results of the Help Desk and Desktop Support Request for Proposal process, the first service to be subject to competitive

bidding. The selection committee has recommended a contract with En Pointe Technologies, Inc. Based on the proposal, the City anticipates saving approximately \$1.5 million annually. Savings associated through competitively bidding on the other information technology services are expected to be more significant. The full City Council will determine if the first contract is awarded to En Pointe in the weeks ahead. In the event this contract is not awarded as recommended, additional budgetary actions will be needed to offset or mitigate the savings that were originally anticipated for FY 2011.

#### Mitigation Efforts and General Fund Reserve

Overall, the Mid-Year Report shows an estimated net shortfall of \$11.2 million, based on current projections. While this could impact the General Fund reserve if realized, the shortfall is expected to be mitigated by additional savings to be achieved in the areas of information technology and equipment usage charges that have not yet been fully determined, but appear to be attainable. In addition, departments have typically been optimistic in their end-of-year spending estimates, and it is expected that savings will accrue by not meeting these projections. It is our understanding that it is the intention that the 7 percent General Fund reserve target will be maintained and achieved at year-end. If that is the case, it would have been preferred that the Mid-Year Report more clearly articulate the mitigation efforts which will be utilized to achieve a balanced budget, without the use of the General Fund reserve.

## CONCLUSION

Financial Management staff presented the Mid-Year Budget Monitoring Report to the Budget and Finance Committee meeting of March 3, 2010. At the meeting, our office made verbal remarks regarding the potential impact to the Fiscal Year 2011 General Fund Budget due to reduced revenue estimates as described in the Mid-Year Report.

The Budget and Finance Committee requested that the Mid-Year Budget Monitoring Report be forwarded to the City Council, and also requested that the IBA prepare a report on the projected deficit for Fiscal Year 2011. In addition, a report on vacant positions by department was requested, with an indication of which positions are revenue generating.

Based on our review of revised revenue projections and known expenditure changes, the IBA estimates that an additional General Fund deficit of \$45 million could be expected for FY 2011. This is comprised of additional revenue reductions of approximately \$30 million, and an increase to the Retirement ARC payment of \$15 million.

The Mayor's Proposed Budget is required to be released by April 15, according to the City Charter. It is hoped that the proposed budget will include solutions to address this increased budget deficit. The IBA will begin its review of the Proposed Budget as soon as it becomes available.

**[SIGNED]**

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